

REPORT OF EXAMINATION

GRANGE INSURANCE ASSOCIATION

Seattle, Washington

As of December 31, 2001



Participating States:
Washington
Oregon

Grange Insurance Association

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Grange Insurance Association of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2001.



PATRICK H. McNAUGHTON
Chief Examiner

July 31, 2003
Date

Grange Insurance Association

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Grange Insurance Association

Seattle, Washington
July 30, 2003

The Honorable Alfred W. Gross
Commissioner,
Commonwealth of Virginia
Chair, NAIC Financial Condition (EX)
Committee
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

The Honorable John Morrison
Commissioner, Montana Department of
Insurance
NAIC Secretary, Western Zone
840 Helena Avenue
Helena, MT 59601

The Honorable Mike Kreidler
Commissioner, Washington State Office of
Insurance Commissioner
5000 Capital Boulevard
PO Box 40255
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

GRANGE INSURANCE ASSOCIATION

of

Seattle, Washington

hereinafter referred to as "GIA" or the "Association," at the location of its home office, 200 Cedar Street, Seattle, WA 98121-1223. This report is respectfully submitted showing the condition of the Association as of December 31, 2001.

Grange Insurance Association

SCOPE OF EXAMINATION

This examination covers the period January 1, 1995 through December 31, 2001 and comprises a comprehensive review of the books and records of the Association. The examination followed the statutory requirements contained in the Washington Insurance Code and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

INSTRUCTIONS

The examiners reviewed the Association's filed 2001 Annual Statement as part of the statutory examination. The review focused on determining if the Association's Annual Statement was completed in accordance with the Annual Statement Instructions published by the NAIC and on determining if the Association's accounts and records were prepared and maintained in accordance with Title 48 of the Revised Code of Washington and Title 284 of the Washington Administrative Code.

The following summarizes the exceptions noted while performing this review.

1. Intercompany Service Agreement

The Intercompany Service Agreement is dated March 11, 1986. The agreement is not specific as to what kinds of service the Association provides Rocky Mountain Fire & Casualty Company nor the method of expense allocation.

These affiliate services performed by the Association are required to be "fair and reasonable" as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i)&(ii). In addition, RCW 48.31B.030(1)(a) requires: "(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied; (iv) The books, accounts, and records of each party to such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties." (See Page 14, "Intercompany Service Agreement")

The Association is instructed to update the Intercompany Service Agreement to specifically outline the services GIA will perform for Rocky Mountain Fire & Casualty Company and the Mayflower Corporation. This formal agreement should be in written form, outline the services provided, allocation process, mode of repayment and timelines of the payment, as required by RCW 48.31B.030(1)(b)(iv).

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The Association is instructed pursuant to RCW 48.31B.030(1)(b)(iv) to submit for approval to the Washington State Office of Insurance Commissioner an Intercompany Service Agreement with Rocky Mountain Fire & Casualty Company and Mayflower Corporation which complies with RCW 48.31B.030(1)(a).

2. Outstanding Checks

The Association classifies outstanding checks as Drafts Outstanding. According to the NAIC Accounting Practices and Procedures Manual, SSAP No. 2, Paragraph 7, drafts and checks have different legal characteristics. A check is payable on demand, whereas a draft must be approved for payment by the reporting entity before it is honored by the bank. Because of these different characteristics, a draft meets the definition of a liability as defined by SSAP No. 5 — Liabilities, Contingencies and Impairments of Assets. Outstanding checks are accounted for as a reduction of cash. (See Page 15, “Outstanding Checks”)

The Association is instructed to report its cash balance net of outstanding checks, in accordance with the NAIC Accounting Practices and Procedures Manual, SSAP No. 2, Paragraph 7 and RCW 48.05.073.

3. Guaranty Assessment

The Association did not accurately report its receivable for guaranty fund assessments that are subject to future premium tax offset. The receivable balance was under valued by \$22,927 for future offsets available in the state of Oregon. No examination adjustment was included since this amount is below the materiality level and deemed immaterial. (See Page 13, “Guaranty Assessment”)

The Association is instructed to correctly record guaranty fund assessments as a receivable for future premium tax offsets, in accordance with each state’s filing guidelines, RCW 48.05.250 and the NAIC Annual Statement Instructions.

4. Real Estate: Properties Occupied by the Company

The Association includes in its financial statements a condominium located in Seattle, valued at \$141,012, as Properties Occupied by the Company. The condominium is owned free and clear but is not used as a Home Office. It is used as living quarters for the President when in town. The condominium should be reported as a non-admitted asset, per RCW 48.13.160. (See Page 15, “Real Estate: Properties Occupied by the Company”)

The Association is instructed to either obtain a Special Consent from the Commissioner to report the condominium as an admitted asset or to non-admit the condominium in future filings, in accordance with RCW 48.13.160.

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5. Imputed Office Rent

The per square foot amount the Association charges RMFCC for office rent is low in consideration of the proximity of the location to downtown Seattle. The distribution of square footage utilized by Association is current but the charge per square foot has not been changed since August 1, 1998. The rent expense charged to RMFCC by the Association is required to be “fair and reasonable” as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i)&(ii). (See Page 13, “Imputed Office Rent”)

The Association is instructed to review, assess and recalculate the current market prices for rent amounts in compliance with RCW 48.31B.030(1)(a)(i)&(ii) which states the terms and charges for transactions or services rendered within a holding company system must be fair and reasonable.

COMMENTS AND RECOMMENDATIONS

1. Custodial Account and Agreement

The Custodial Agreement does not incorporate all the safeguards as suggested by the NAIC. The agreement does not include provisions for indemnifying the Association for lost securities. (See Page 13, “Custodial Agreement”)

It is recommended the Association execute a custodial agreement with a bank, trust company or security depository that includes the required provisions for indemnifying the Association for lost securities, as presented by the NAIC Financial Condition Examiners Handbook, Part 1 - General, IV. Conducting Examinations, Section J.

HISTORY

The Company was incorporated on April 4, 1894 as a fraternal fire association, domiciled in the state of Washington, with the name Washington Fire Relief Association. The Association’s Certificate of Authority to act as an insurer was issued on February 26, 1912. On August 6, 1931, the Articles of Incorporation were amended so that the Association could operate on a cash premium basis as a fraternal mutual insurance company.

In 1933, the Association ceased premium operations on the assessment basis and changed to a legal reserve basis. The Association’s name was changed in 1936 to the Grange Fire Insurance Association and again in 1943 to its present name, the Grange Insurance Association. Pursuant to RCW 48.09.270(3), in July of 1960, the assessment feature of the Association’s policies was eliminated.

Grange Insurance Association

The Amended Articles of Incorporation and Amended Bylaws have been filed with and approved by the Washington State Office of Insurance Commissioner (OIC) and filed with the Secretary of State.

MANAGEMENT AND CONTROL

Members (Patrons of Husbandry)

Article III, paragraph 1, of the Articles of Incorporation provides that the purpose of the Association is to engage generally in the insurance business as a fraternal mutual insurer, insuring only the risks of those members in good standing of the Patrons of Husbandry, commonly called the "Grange". Article I, Section 2, of the Association's Bylaws, as amended June 14, 1976, also provides that insurance by the Association shall be confined to members of the Patrons of Husbandry.

Article V, Section I, of the Bylaws, further provides that the annual meeting of the Association members shall be held at the home office on the third Monday of March. Fifty (50) Association members, excluding directors, shall constitute a quorum at any regular or special meeting, with members having a personal vote or proxy upon any matter coming before such meeting.

A quorum was present at all Annual Meetings during the period covered by this examination.

Board of Directors

Article II, Section I, of the Bylaws, vests the management of the property and business of the Association in a Board of Directors. The number of directors shall be no less than one (1) but in no event shall the number of directors exceed fifteen (15).

No person shall be eligible for nomination or election as director unless he/she has been a member of the Patrons of Husbandry for not less than five years. No one can be a director who has a full time salaried position (other than that of a director) with this Association or any of its affiliates or with any other local or state grange or of any of their affiliates or who is a director or employee of another insurance company not affiliated with this Association.

The Bylaws state that the Board of Directors shall select an Executive Committee consisting of the President, Vice President of the Board and three directors who shall have the full power to act for the Board between meetings, except as the Board may otherwise direct. The Board may constitute other permanent or temporary committees and delegate thereto such powers as deemed necessary. In accordance with WAC 284-36-020 and 030, Grange members who are agents of the Association may be appointed as

Grange Insurance Association

directors of the Association, provided that the number of agent-directors does not exceed one-third (to the nearest whole number) of the total regular membership of the Board.

The officers of the Association shall be chosen by the directors and shall consist of the President, one or more Vice Presidents, a Secretary, a Treasurer, one or more Assistant Secretaries, and one or more Assistant Treasurers. The same individual may hold at the same time any two offices except for those of President and Vice President. Only the President and Vice President shall be elected from among the members of the Board.

The following directors were elected to serve the Association as of December 31, 2001:

Donald L. Wade	Past President - GIA
Larry D. Tanneberg	President - Larry Tanneberg Farms and Tanneberg Insurance Agency
Frederick P. Church	Past President - GIA; Secretary and Vice Chairman- People's Community Credit Union
Arthur R. Peterson	Owner - Art Peterson Insurance Agency
Randall A. Lewis	Owner - Lewis Insurance Agency; Captain - Los Angeles Fire Department
Donald A. Steffen	Retired Dairy Farmer
Myrtle J. Reed	Master – Roxy Ann Grange
Rosemary K. Hansen	Owner/Manager of commercial properties; Retired Insurance Agent
Benjamin D. Metzler	President of GIA
Ronald G. Miller	Retired from GIA
D. Thomas McKern	Owner/operator - McKern Farms
Darelld B. Larrigan	Retired Grange Member; Former Marketing Manager - GIA.
Robert L. Shea	Retired Insurance Agent - GIA

Officers

The principal executive officer of the Association is Ryan M. Dudley, Executive Vice President. Mr. Dudley has been with the GIA for more than ten (10) years.

The following officers were elected to serve the Association as of December 31, 2001:

Benjamin D. Metzler	President
Ryan M. Dudley	Executive Vice President
David E. Suver	Secretary
Sean I. McGourty	Chief Financial Officer

Grange Insurance Association

AFFILIATED COMPANIES

Grange Insurance Association is a member of a holding company system regulated pursuant to Chapter 48.31B RCW. The Association is required to file holding company statements under RCW 48.31B.25 (1) (c), RCW 48.31B.025 (3), WAC 284-18-390 and WAC 284-18-400. Within the holding company structure, GIA controls through direct and indirect stock ownership the affiliates listed below:

Mayflower Corporation

Mayflower Corporation, an insurance holding company, was created by the management of the Association and was incorporated under the laws of the state of Washington on November 6, 1956. All 1,000 shares of its authorized common stock are wholly-owned by GIA. On April 2, 1959, Mayflower Corporation created a new property and casualty stock insurance company called Rocky Mountain Fire & Casualty Company. As of December 31, 2001, Mayflower Corporation owns 99.9% of the outstanding common stock shares of Rocky Mountain Fire & Casualty Company.

Rocky Mountain Fire & Casualty Company

Rocky Mountain Fire & Casualty Company (RMFCC) was formed through the process of assimilating the assets, liabilities, and insurance obligations of a similarly named company, the Rocky Mountain Fire Insurance Company located in Great Falls, Montana, with the insurance operation of the Seattle, Washington company called Mayflower Insurance Exchange. RMFCC writes property and casualty insurance primarily for the general public who are not members of the Order of Patrons of Husbandry (Grange members).

Grange Insurance Association made surplus contributions to RMFCC in the amounts of \$1,500,000 in 1980, \$2,500,000 in 1988, \$2,400,000 in 1990, \$2,700,000 in 1993. Rocky Mountain Fire & Casualty Company issued Surplus Contribution Notes to GIA in return.

Grange Insurance Association has Federal Income Tax and Intercompany Expense Sharing Agreements with affiliates which include but are not limited to the following:

- Federal Income Taxes
- Claims Administration Services
- Investment Services
- Data Processing and Accounting Services
- Personnel and Related Services
- Underwriting and Policy Service Functions

Grange Insurance Association

CORPORATE RECORDS

The examiners reviewed the corporate records of GIA for the period under examination. All Board meetings were conducted with a quorum present. The Board members ratified all changes to the Articles of Incorporation and Bylaws.

INTERNAL SECURITY

Conflict of Interest

Grange Insurance Association has an established procedure for disclosure to its Board of Directors of any affiliation on the part of its officers, directors and key employees which is in conflict with their official duties. The Corporate Secretary and Executive Vice President review the Conflict of Interest Statements annually for conflicting situations and take appropriate action thereupon.

Fidelity Bond and Other Insurance

The Association and its affiliate companies are the named insureds on various insurance policies including property and general liability loss, difference in conditions, commercial excess umbrella liability, excess liability, workers' compensation and employers' liability, fidelity, fiduciary liability, errors and omissions and directors and officers liability coverage.

The Association's fidelity coverage of \$1,000,000 meets the suggested NAIC minimum coverage.

TERRITORY AND PLAN OF OPERATIONS

Grange Insurance Association is authorized to do business in California, Colorado, Idaho, Montana, Nebraska, Oregon, Washington, and Wyoming.

GROWTH OF COMPANY

The following schedules reflect the growth of the Association by year beginning in 1995. The amounts shown were compiled from the Association's filed Annual Statements and were adjusted to reflect examination adjustments:

Grange Insurance Association

Schedule 1

<u>Year</u>	Admitted <u>Assets</u>	<u>Liabilities</u>	Surplus & <u>Other Funds</u>
2001	163,706,581	88,271,762	75,434,819
2000	177,893,457	96,128,988	81,764,469
1999	180,723,087	96,308,476	84,414,611
1998	177,286,454	107,385,946	69,900,508
1997	170,562,626	112,933,723	57,628,903
1996	170,398,601	115,409,699	54,988,902
1995	169,688,366	127,485,267	42,203,099

Schedule 2

<u>Year</u>	Premiums <u>Earned</u>	Net Underwriting <u>Deductions</u>	Underwriting <u>Gain or Loss</u>	Investment and <u>Other Income</u>	Pre-Tax <u>Income</u>
2001	95,278,969	106,418,351	(11,139,383)	9,649,832	(1,489,550)
2000	92,073,496	99,170,142	(7,096,646)	10,475,989	3,379,343
1999	93,013,712	93,015,672	(1,960)	12,682,061	12,680,101
1998	97,482,384	96,482,687	999,697	10,985,046	11,984,743
1997	100,844,629	114,173,336	(13,328,707)	13,631,786	303,078
1996	100,001,938	99,617,650	384,288	11,216,610	11,600,898
1995	103,629,376	120,209,576	(16,580,200)	10,900,564	(5,679,636)

REINSURANCE

Grange Insurance Association participates in quota share and catastrophe treaties. Each of these treaties is spread across an extensive portfolio of reinsurers, limiting any concentrated assumed risk.

Following is a summary of the terms and conditions of the Association reinsurance program:

Property & Casualty – Inter-company (Per Risk Assumed)

Coverage:	RMFCC - \$100,000 excess of \$150,000 retention
Rate:	2.25% of subject earned premium
Reinsurer:	Grange Insurance Association
Comments:	Rate increased from 2.15%, January 1, 2000, based on loss experience.

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Property & Casualty (Per Risk)

Coverage: Property - \$2,250,000 excess of \$250,000 retention.
Casualty - \$2,750,000 excess of \$250,000 retention.

Rate: 1.695% of subject earned premium (First Excess 1.52%, Second Excess 0.175%)

Reinsurer: Swiss Re America

Profit Sharing: (First Excess layer only) 50% of the reinsurer's net profit for each underwriting year within a three year period, after 15% expense.

Comments: Treaty renewed for 2000 and 2001 at the same limits, rate, and conditions as 1999.

Property Catastrophe (Per Occurrence)

Coverage: 95% of \$19,000,000 excess of \$2,000,000 retention.

Rate: 3.511% of subject earned premium (Note: SEP is net after deducting the cost of the single risk program).

Reinsurer: Lloyds provides over 75% of the cover. The remaining coverage is provided by CNA, GE, and R & V Versicherung.
Note: John B. Collins Associates, Inc., broker for this program.

Comments: Rate and limits were unchanged from the 2000 contract.

Umbrella Excess Liability Quota Share

Coverage: 92.5% of the amount of net loss allocated to the first \$1,000,000 of coverage and 100% of the amount of net loss for policy limits in excess of \$1,000,000.

Rate: 92.5% of the direct written premium charged by the Company for policy limits up to and including \$1,000,000, and 100% of the direct written premium charged by the Company for policy limits in excess of \$1,000,000.

Commission Rate: 30%

Grange Insurance Association

Reinsurer: General Reinsurance Corporation

Comments: Coverage and rate unchanged from 2000.
The Company issues policies up to \$5,000,000.

Reinsurance Intermediary

Grange Insurance Association utilizes the services of a reinsurance intermediary, John B. Collins Associates, Inc., to solicit, negotiate, and place reinsurance cessions on behalf of the Association. A review of the contracts and licenses of the reinsurance intermediary noted that the intermediary is licensed by Minnesota but not by Washington State, which is permitted according to RCW 48.94.010(1) (b).

ACCOUNTING RECORDS AND PROCEDURES

Grange Insurance Association maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) modified accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for Annual Statement reporting.

The Annual Statements filed with the Washington State Office of Insurance Commissioner during the examination period were examined and reviewed to verify that they were prepared in a manner consistent with the statutory requirements of Title 48 Revised Code of Washington, Title 284 Washington Administrative Code, the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners. The following areas deviated from those standards and procedures:

Losses and Loss Adjustment Expenses

The reserves carried by the Association for these liabilities were \$32,168,383 and \$5,690,677, respectively, as of December 31, 2001.

The reserves were reviewed by the casualty actuarial staff of the OIC. Association personnel provided loss and loss adjustment expense development data by line of business as of December 31, 2002. (In other words, the data included 12 months of development subsequent to the examination period.) Association personnel provided additional information by electronic mail and in a face-to-face meeting. Actuarial staff also reviewed an actuarial report prepared by the Association's consulting actuarial firm, Milliman USA, Inc.

Based on their analysis of data through December 31, 2002, the OIC's actuarial staff concluded that the Association's booked reserves were deficient as of December 31, 2001. Since December 31, 2001, the Association has taken significant steps to strengthen its loss and loss adjustment expense reserves for 2001 and prior years. These steps are

Grange Insurance Association

reflected in the one-year loss development of \$4,206,000 shown on Page 23 of the Association's Annual Statement for 2002.

The OIC's actuarial staff recommended the following examination adjustments to reserves as of December 31, 2001:

	<u>Booked Reserve</u>	<u>Examination Adjustment</u>	<u>Restated Reserve</u>
Losses	\$32,168,383	\$2,532,000	\$34,700,383
Loss adjustment expenses	5,690,677	2,064,000	7,754,677

Disaster Recovery Plan and Business Contingency Plan

The Association's Disaster Recovery/Business Contingency Plan is not current. GIA issued a Request for Proposals (RFP) which was sent to potential outside vendors who would assist the Company in preparing a plan. The RFP provides a background of the Company, a description of the current operational set-up and the critical areas the plan needs to address.

During the examination, GIA signed an agreement with Ernst & Young, LLP, to assist the Company in preparing and testing a plan. The plan has been completed and reviewed by the examiners but has not yet been tested.

Imputed Office Rent

The per square foot amount the Association charges RMFCC for office rent is low in consideration of the proximity of the location to downtown Seattle. The distribution of square footage utilized by Association is current but the charge per square foot has not been changed since August 1, 1998. The rent expense charged to RMFCC by the Association is required to be "fair and reasonable" as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i)&(ii). (See Instructions No. 5)

Guaranty Assessment

The Association did not accurately report its receivable for guaranty fund assessments that are subject to future premium tax offset. The receivable balance was under valued by \$22,927 for future offsets available in the state of Oregon. No examination adjustment was included since this amount is below the materiality level and deemed immaterial. (See Instructions No. 3)

Custodial Agreement

The Custodial Agreement with the Bank of New York Western Trust does not incorporate all the safeguards as suggested by the NAIC. Specifically, the agreement should include the following:

Grange Insurance Association

- That the bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody, except that, unless domiciliary state law, regulation, or administrative action otherwise require a stricter standard (Section 1.b. sets forth an example of such a stricter standard), the bank or trust company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the bank or trust company;
- If domiciliary state law, regulation, or administrative action requires a stricter standard of liability for custodians of insurance company securities than that set forth in Section 1.a., then such stricter standard shall apply. An example of a stricter standard that may be used is that the bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody occasioned by the negligence or dishonesty of the bank or trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction;
- That in the event of a loss of the securities for which the bank or trust company is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced; and may provide; That the bank or trust company shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.

(See Comments and Recommendations No. 1)

Intercompany Service Agreement

The Association's Intercompany Service Agreement is dated March 11, 1986. The agreement is not specific as to what kinds of service the Association provides RMFCC and Mayflower Corporation nor the method of expense allocation.

These affiliate services performed by the Association are required to be "fair and reasonable" as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i)&(ii). In addition, RCW 48.31B.030(1)(a) requires: "(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied; (iv) The books, accounts, and records of each party to such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to

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support the reasonableness of the charges or fees to the respective parties.” (See Instructions No. 1)

Outstanding Checks

The Association classifies outstanding checks as Drafts Outstanding. According to the NAIC Accounting Practices and Procedures Manual, SSAP No. 2, Paragraph 7, drafts and checks have different legal characteristics. A check is payable on demand, whereas a draft must be approved for payment by the reporting entity before it is honored by the bank. Because of these different characteristics, a draft meets the definition of a liability as defined by SSAP No. 5 — Liabilities, Contingencies and Impairments of Assets. Outstanding checks are accounted for as a reduction of cash. (See Instructions No. 2)

Real Estate: Properties Occupied by the Company

The Association includes in its financial statements a condominium located in Seattle, valued at \$141,012, as Properties Occupied by the Company. The condominium is owned free and clear but is not used as a Home Office. It is used as living quarters for the President when in town. The condominium should be reported as a non-admitted asset, per RCW 48.13.160. (See Instructions No. 4)

EDP SYSTEMS AND OPERATIONS

The management of GIA is sufficiently knowledgeable of EDP issues and the various department managers work with the IS Department to provide direction and oversight. Systems development, acquisition and maintenance controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. GIA has detailed written documentation for its major operations and financially significant applications. There is proper supervision and review for each project to ensure satisfactory completion.

SUBSEQUENT EVENTS

1. Paid in Capital

In the Board Minutes of June 21, 2002, it was noted that OIC had notified RMFCC that its surplus was not adequate to continue writing business at the current annual level of written premiums. The Association’s Board authorized an \$8.37 million transfer to RMFCC. A review of the filed RMFCC Quarterly Statement as of June 30, 2002, reflected the transfer as Paid in Capital.

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2. Reinsurance

The reinsurance contract with Swiss Re was terminated effective January 1, 2002 and will be replaced by GMAC. GMAC will provide the same coverage to the Association and will increase the retention levels to \$500,000.

The reinsurance limit assumed for the intercompany reinsurance agreement with RMFCC increased to \$350,000 and the premium rates also increased.

3. New Business from failed Oregon's Grange

In the Board Meeting of March 2002, it was noted that Grange Mutual Insurance Co. (GMIC) an Oregon domiciled fraternal company, had ceased writing business and perhaps GIA would take over the book of business. Subsequently, GIA agreed to accept a limited amount of business and three (3) agents from GMIC.

4. Investments

The Association holds a \$1 million bond in Tyco which has been downgraded to non investment grade by the NAIC Securities Valuations Office (SVO). On June 28, 2002, the NAIC assigned a "3" rating and a value of \$769,350. This information was taken from the NAIC SVO's disk distributed as of June 30, 2002. This bond was purchased in 2001 at a discount. The Tyco bond has subsequently recovered to \$935,000 at the end of 2002.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The prior examination report dated December 31, 1994, included the following recommendations:

1. Disaster Responses Plan

It was recommended that the Association establish a disaster plan for the use of alternative facilities. It was recommended that such a plan be established and rehearsals should periodically be conducted to test the adequacy of the plan.

After the prior examination, GIA began the process of writing a disaster recovery plan that was to include the use of an alternate site for processing. A committee consisting of individuals from each department was assigned to write, test and implement the plans. In 1996, before the plan was completed and implemented, the committee was disbanded by senior management due to a lack of funds and a change in priorities caused by operating losses. Progress on the plan was never resumed.

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During the current examination, GIA signed an agreement with Ernst & Young, LLP, to assist the Company in preparing and testing a plan. The plan has been completed and reviewed by OIC but has not yet been tested.

2. Documentation

It was recommended that the Association document all programs and procedures.

The Association responded to this recommendation by improving program documentation.

3. Personal Computer Controls

It was recommended that GIA install virus detection programs, update them periodically and use them regularly on all personal computers to detect computer viruses.

Currently, virus protection software is being used by the Association.

4. Federal Income Taxes

It was recommended that the Association amend the Inter-Company Federal Income Tax Agreement to state that no company will be worse off than it would be on a stand alone or separate return basis, and the Association should keep track of inter-company utilization of tax benefits, such as net operating loss carry forwards.

The Association responded to this recommendation by amending the agreement to reflect these changes.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Grange Insurance Association as of December 31, 2001:

Statement of Assets, Liabilities, Surplus and Other Funds
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Seven Year Reconciliation of Surplus and Other Funds

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Statement of Assets, Liabilities, Surplus and Other Funds December 31, 2001

	<u>Balance Per Company</u>	<u>Adj. No.</u>	<u>Examination Adjustments</u>	<u>Ref.</u>	<u>Balance Per Examination</u>
Assets					
Bonds	\$103,484,246			(2A)	\$103,484,246
Stocks:					
Preferred stocks	1,411,000			(2B)	1,411,000
Common Stock	31,379,940			(2C)	31,379,940
Real estate, property occupied by the company	5,639,818	(4)	\$(141,012)		5,498,806
Cash and short term investments	6,207,065	(1)	(4,302,266)	(2D)	1,904,799
Agents' balances or uncollected premiums					
Premiums and agents' balances in course of collection	13,004,318				13,004,318
Reinsurance recoverable on loss adjustment expense payment	149,178				149,178
Federal income tax recoverable and interest thereon	3,999,137				3,999,137
Electronic data processing equipment and software	743,468				743,468
Interest, dividends and real estate income due and accrued	1,415,987				1,415,987
Receivable from parent, subsidiaries and affiliates	574,690			(3)	574,690
Total assets	\$168,008,847		\$(4,443,278)		\$163,565,569
Liabilities, Surplus and Other Funds					
Losses	\$32,168,383	(2)	\$2,532,000	(5)	\$34,700,383
Reinsurance payable on paid loss and loss adjustment expenses	43,390				43,390
Losses adjustment expenses	5,690,677	(3)	2,064,000	(5)	7,754,677
Commission payable, contingent commissions and other similar charges	120,491				120,491
Other expenses (excluding taxes, licenses and fees)	1,681,963				1,681,963
Taxes, licenses and fees (excluding federal and foreign income taxes)	336,619				336,619
Unearned premiums	34,994,277				34,994,277
Ceded reinsurance premiums payable	468,795				468,795
Amount withheld or retained by company for account of others	164,449				164,449
Provision for reinsurance	69,406				69,406
Draft outstanding	4,302,266	(1)	(4,302,266)		0
Payable for securities	13,584				13,584
Aggregate write-ins for liabilities	7,923,728				7,923,728
Total liabilities	87,978,028		293,734		88,271,762
Aggregate write-ins for other than special surplus funds	1,250,000				1,250,000
Unassigned funds	78,780,819		(4,737,012)		74,043,807
Total surplus and other funds	80,030,819		(4,737,012)		75,293,807
Total liabilities, surplus and other funds	\$168,008,847		\$(4,443,278)		\$163,565,569

Grange Insurance Association

Underwriting and Investment Exhibit Statement of Income For the Year Ended 2001

	<u>Balance</u> <u>Per Company</u>	<u>Adj.</u> <u>No.</u>	<u>Examination</u> <u>Adjustments</u>	<u>Ref.</u>	<u>Balance Per</u> <u>Examination</u>
Premiums earned	\$95,278,969				\$95,278,969
Deductions					
Loss incurred	63,032,711	(2)	\$2,532,000		65,564,711
Loss expenses incurred	9,963,197	(3)	2,064,000		12,027,197
Other underwriting deductions	28,826,443				28,826,443
Total underwriting deductions	<u>101,822,351</u>		<u>4,596,000</u>		<u>106,418,351</u>
Net underwriting gain or (loss)	(6,543,383)		(4,596,000)		(11,139,383)
Investment Income					
Net investment income earned	6,545,526				6,545,526
Net realized capital gains or (losses)	2,105,330				2,105,330
Net investment gain or (loss)	<u>8,650,856</u>				<u>8,650,856</u>
Other Income					
Aggregate writs-ins for miscellaneous income	(61,019)				(61,019)
Net gain or (loss) from agents' or premium balances charged off	1,056,775				1,056,775
Finance and service charges not included in premiums	3,220				3,220
Total Other Income	<u>998,976</u>				<u>998,976</u>
Net income before dividends to policyholders but before federal and foreign income taxes	3,106,450		(4,596,000)		(1,489,550)
Federal and foreign income taxes incurred	825,220				825,220
Net Income	<u>\$2,281,230</u>		<u>\$(4,596,000)</u>		<u>\$(2,314,770)</u>
Surplus and Other Funds					
Surplus as regards policyholders, December 31, 2000	<u>\$81,764,469</u>				<u>\$81,764,469</u>
Net income	2,281,230		\$(4,596,000)		(2,314,770)
Net unrealized capital gains or (losses)	(7,299,342)				(7,299,342)
Change in net deferred income tax	1,874,821				1,874,821
Change in nonadmitted assets	(250,346)	(4)	(141,012)		(391,358)
Change in provision for reinsurance	(32,726)				(32,726)
Cumulative effects of changes in accounting principles	1,417,903				1,417,903
Aggregate write-ins for gains and losses in surplus	274,810				274,810
Change in surplus as regards policyholders for the year	<u>(1,733,650)</u>		<u>(4,737,012)</u>		<u>(6,470,662)</u>
Surplus as regards policyholders, December 31, 2001	<u>\$80,030,819</u>		<u>\$(4,737,012)</u>		<u>\$75,293,807</u>

Grange Insurance Association

Analysis of Examination Changes in Financial Statements December 31, 2001

	<u>Adj.</u> <u>No.</u>	<u>Increase/</u> <u>(Decrease)</u>	<u>Balance Per</u> <u>Examination</u>
Surplus as regards policyholders, per company			\$80,030,819
Assets			
Cash and short term investments			
Outstanding checks recorded as a liability	(1)	\$(4,302,266)	
Real Estate: Properties occupied by the company			
Non-admit the condominium	(4)	(141,012)	
Liabilities			
Losses			
Reserves were deficient	(2)	(2,532,000)	
Loss adjustment expenses			
Reserves were deficient	(3)	(2,064,000)	
Draft outstanding			
Outstanding checks recorded as a liability	(1)	<u>4,302,266</u>	
Net increase/(decrease) to surplus			<u>(4,737,012)</u>
Surplus as regards policyholders, per examination			<u>\$75,293,807</u>

Grange Insurance Association

Comparative Statement of Assets, Liabilities, Surplus and Other Funds For December 31,

Assets	<u>2001*</u>	<u>2000</u>
Bonds	\$103,484,246	\$104,515,738
Stocks:		
Preferred stocks	1,411,000	405,000
Common Stock	31,379,940	37,235,287
Real estate, property occupied by the company	5,498,806	4,718,048
Cash and short term investments	1,904,799	6,950,540
Agents' balances or uncollected premiums		
Premiums and agents' balances in course of collection	13,004,318	12,150,014
Premiums, agents' balances and installments booked but deferred and yet due	0	8,392,115
Reinsurance recoverable on loss adjustment expense payment	149,178	1,381
Federal income tax recoverable and interest thereon	3,999,137	255,003
Electronic data processing equipment and software	743,468	236,375
Interest, dividends and real estate income due and accrued	1,415,987	1,698,290
Receivable from parent, subsidiaries and affiliates	574,690	1,335,666
Total assets	<u>\$163,565,569</u>	<u>\$177,893,457</u>
Liabilities, Surplus and Other Funds		
Losses	\$34,700,383	\$32,983,771
Reinsurance payable on paid loss and loss adjustment expenses	43,390	1,716
Losses adjustment expenses	7,754,677	6,212,919
Commission payable, contingent commissions and other similar charges	120,491	0
Other expenses (excluding taxes, licenses and fees)	1,681,963	1,999,230
Taxes, licenses and fees (excluding federal and foreign income taxes)	336,619	344,522
Federal and foreign income taxes	0	307,665
Unearned premiums	34,994,277	43,934,825
Ceded reinsurance premiums payable	468,795	0
Amount withheld or retained by company for account of others	164,449	265,482
Provision for reinsurance	69,406	36,680
Draft outstanding	0	4,178,746
Payable for securities	13,584	0
Aggregate write-ins for liabilities	7,923,728	5,863,432
Total liabilities	<u>88,271,762</u>	<u>96,128,988</u>
Aggregate write-ins for other than special surplus funds	1,250,000	1,250,000
Unassigned funds	74,184,819	70,514,469
Total surplus and other funds	<u>75,293,807</u>	<u>81,764,469</u>
Total liabilities, surplus and other funds	<u>\$163,565,569</u>	<u>\$177,893,457</u>

* = Audited balances.

Grange Insurance Association

Comparative Underwriting and Investment Exhibit Statement of Income For the Years Ended December 31.

	<u>2001*</u>	<u>2000</u>
Premiums earned	\$95,278,969	\$92,073,496
Deductions		
Loss incurred	65,564,711	60,372,086
Loss expenses incurred	12,027,197	9,726,688
Other underwriting deductions	28,826,443	29,071,368
Total underwriting deductions	<u>106,418,351</u>	<u>99,170,142</u>
Net underwriting gain or (loss)	(11,139,383)	(7,096,646)
Investment Income		
Net investment income earned	6,545,526	8,190,458
Net realized capital gains or (losses)	2,105,330	1,281,380
Net investment gain or (loss)	<u>8,650,856</u>	<u>9,471,838</u>
Other Income		
Aggregate writs-ins for miscellaneous income	(61,019)	(36,513)
Net gain or (loss) from agents' or premium balances charged off	1,056,775	1,034,679
Finance and service charges not included in premiums	3,220	5,985
Total Other Income	<u>998,976</u>	<u>1,004,151</u>
Net income before dividends to policyholders but before federal and foreign income taxes	(1,489,550)	3,379,343
Federal and foreign income taxes incurred	825,220	1,056,437
Net Income	<u><u>\$ (2,314,770)</u></u>	<u><u>\$ 2,322,906</u></u>
Surplus and Other Funds		
Surplus as regards policyholders, December 31, 2000	<u>\$81,764,469</u>	<u>\$84,414,611</u>
Net income	(2,314,770)	2,322,906
Net unrealized capital gains or (losses)	(7,299,342)	(4,290,975)
Change in net deferred income tax	1,874,821	0
Change in nonadmitted assets	(391,358)	(147,475)
Change in provision for reinsurance	(32,726)	(3,958)
Cumulative effects of changes in accounting principles	(1,417,903)	0
Aggregate write-ins for gains and losses in surplus	274,810	(530,640)
Change in surplus as regards policyholders for the year	<u>(6,470,662)</u>	<u>(2,650,142)</u>
Surplus as regards policyholder, December 31, 2001	<u>\$75,293,807</u>	<u>\$81,764,469</u>

* = Audited balances.

Grange Insurance Association

Seven Year Reconciliation of Surplus
For the Years Ended December 31,

	<u>2001*</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1997</u>	<u>1995</u>
Surplus as regards policyholders, December 31, previous	81,764,469	84,414,611	69,900,508	57,628,904	54,988,902	42,203,099	43,757,211
Net income	(2,314,770)	2,322,906	10,313,143	9,726,168	347,834	10,901,869	(5,679,636)
Change in unrealized capital gains or (losses)	(7,299,342)	(4,290,975)	3,185,333	4,142,770	1,106,626	3,046,626	5,043,166
Change in net deferred income tax	1,874,821	0	0	0	0	0	0
Change in nonadmitted assets and related items	(391,358)	(147,475)	(776,678)	(530,956)	381,545	(435,756)	(249,008)
Change in provision for reinsurance	(32,726)	(3,958)	(29,941)	(2,781)	0	0	0
Change in excess of statutory reserve over statement reserve	0	0	1,547,000	(1,111,000)	713,000	(769,000)	(327,000)
Cumulative effects of change in accounting Principles	1,417,903	0	0	0	0	0	0
Aggregate write-ins for gains and losses in Surplus	274,810	(530,640)	275,247	47,404	90,997	41,924	(341,634)
Net change in capital and surplus for the year	(6,470,662)	(2,650,142)	14,514,104	12,271,605	2,640,002	12,785,803	(1,554,111)
Capital and surplus, December 31, current	75,293,807	81,764,469	84,414,612	69,900,508	57,628,904	54,988,902	42,203,099

* = Audited balances.

Grange Insurance Association

NOTES TO THE FINANCIAL STATEMENTS

1. Basis of Presentation

The financial statements included herein have been prepared in accordance with accounting practices prescribed or permitted by the Washington State Office of Insurance Commissioner. Prescribed statutory accounting practices include a variety of publications of the NAIC, as well as state laws, regulations, and general administrative rules.

2. Investments

Investments are valued based on the NAIC's Valuation of Securities Manual and Chapter 48.12 of the Revised Code of Washington.

A. Bonds

Bonds are generally reported at amortized cost using the scientific method, which closely approximates the effective interest method. The audited statement values, unrealized gains and losses, estimated market values and acquisition cost of bonds held for investment as of December 31, 2001 were as follows:

	Statement <u>Value</u>	Unrealized Gains/ <u>(Losses)</u>	Market <u>Value</u>	Actual <u>Cost</u>
U.S. Government	\$16,261,762	\$217,474	\$16,479,236	\$16,464,683
States and Territories	2,603,224	118,420	2,721,644	2,621,892
Public Utilities	984,246	(74,246)	910,000	984,000
Political Subdivisions	3,342,378	88,703	3,431,081	3,341,894
Special Revenue	26,077,431	157,306	26,234,737	26,214,938
Industrial & Misc.	<u>54,215,205</u>	<u>473,891</u>	<u>54,689,096</u>	<u>55,160,211</u>
Total	<u>\$103,484,246</u>	<u>\$981,548</u>	<u>\$104,465,794</u>	<u>\$104,787,618</u>

The maturity distribution of all bonds and short term investments owned as of December 31, 2001 was as follows:

	Statement <u>Value</u>	Percent of <u>Portfolio</u>
Due in one year or less	\$ 18,621,523	17.20%
Due over one year through five years	40,795,756	37.72%
Due over five years through ten years	20,472,974	18.93%
Due over ten years through twenty years	15,891,542	14.70%
Over twenty years	<u>12,384,406</u>	<u>11.45%</u>
Total	<u>\$108,166,201</u>	<u>100.00%</u>

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The NAIC Securities Valuation Office's classification distribution as of December 31, 2001 was as follows:

	Statement <u>Value</u>	Percent of <u>Portfolio</u>
Class 1	\$97,179,509	89.84%
Class 2	9,770,489	9.03%
Class 3	1,077,453	1.00%
Class 6	<u>\$138,750</u>	<u>0.03%</u>
Total	<u>\$108,166,201</u>	<u>100.00%</u>

B. Preferred Stocks

Preferred stocks are valued at market. The Book Value, Unrealized Gains and Losses, Estimated Market Values and Actual Cost of common stocks held as of December 31, 2001 were as follows:

	Book <u>Value</u>	Unrealized Gains/ <u>(Losses)</u>	Market <u>Value</u>	Actual <u>Cost</u>
Preferred Stocks	\$1,411,000	\$0	\$1,411,000	\$1,411,000

C. Common Stocks

The Association owns 100% of the common stock of Mayflower Corporation, an insurance holding company domiciled in Washington State. The stock is valued on the equity basis as described in the "Valuation Procedures and Instructions for Bonds and Stocks" of the Purposes and Procedures Manual of the Securities Valuation Office of the NAIC. The Book Value, Unrealized Gains and Losses, Estimated Market Values and Actual Cost of common stocks held as of December 31, 2001 were as follows:

	Book <u>Value</u>	Unrealized Gains/ <u>(Losses)</u>	Market <u>Value</u>	Actual <u>Cost</u>
Common Stocks	\$31,790,940	\$0	\$31,379,940	\$15,828,803

D. Cash And Short-Term Investments

Short-term investments include securities acquired within one (1) year of maturity and are reported at amortized cost, which approximates market value. The statement value of Cash and Short-Term Investments, as of December 31, 2001 were as follows:

Grange Insurance Association

Cash	\$(2,777,157)
Short-Term Investments	<u>4,681,956</u>
Total	<u>\$1,904,799</u>

3. Information Concerning Parent, Subsidiaries and Affiliates

Grange Insurance Association owns all of the outstanding shares of Mayflower Corporation, an insurance holding company domiciled in the state of Washington. Mayflower Corporation owns 99.89% of the outstanding shares of RMFCC.

4. Non-Admitted Assets

Certain assets designated as "non-admitted" have been excluded from the balance sheet. The non-admitted assets are reflected as direct adjustments from net worth. The total non-admitted assets as of December 31, 2001 consisted of the following assets:

Premiums and agents' balances in course of collection	\$499,887
Real Estate: Properties occupied by the company	141,012
Electronic data processing equipment and software	288,998
Contribution Certificate- RMFC	9,100,000
Prepaid & Deposits	2,179,223
Other Assets	<u>2,744,883</u>
Total	<u>\$14,954,003</u>

5. Losses and Losses Adjustment Reserves

The audited reserves for these liabilities were \$34,700,383 and \$7,754,677, respectively, as of December 31, 2001.

The reserves were reviewed by the casualty actuarial staff employed by the OIC. Association personnel provided loss and loss adjustment expense development data by line of business as of December 31, 2002. (In other words, the data included 12 months of development subsequent to the examination period.) Association personnel provided additional information by electronic mail and in a face-to-face meeting. Actuarial staff also reviewed an actuarial report prepared by the Association's consulting actuarial firm, Milliman USA, Inc.

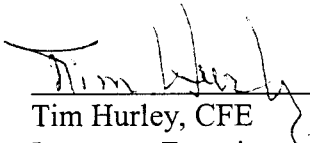
Grange Insurance Association

ACKNOWLEDGMENT

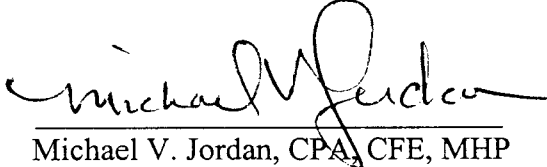
Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Grange Insurance Association during the course of this examination.

In addition to the undersigned, D. Lee Barclay, FCAS, MAAA, Actuary; Keith Henderson, CPA, CFE; John R. Jacobson, AFE; Jeanette Liao, MSF; Tarik Subbagh, CPA, MSBA; all from the Washington State Office of Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Tim Hurley, CFE
Insurance Examiner
State of Oregon



Michael V. Jordan, CPA, CFE, MHP
Examiner-in-Charge
State of Washington

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Michael Uferda

Subscribed and sworn to before me this 3rd day of July, 2003.

Col Jensen

A circular notary seal for Colleen Janisen, a Notary Public in the State of Washington. The seal features a rope-like border. Inside the border, the text "COLLEEN JANISEN" is at the top, "COMMISSION EXPIRES" is on the right, "NOTARY" is in the center with a double-headed arrow below it, "PUBLIC" is below the arrow, and "STATE OF WASHINGTON" is at the bottom. The date "4-1-04" is at the very bottom.